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ABSTRACT

This article examines contract schools and their influence on U.S. education. Schools that are contracted out may be viewed as a privatization development that both parallels and builds upon the charter-school movement. They can be defined as publicly funded schools operated by an independent group of teachers and administrators under a contract with a public agency. This paper focuses on trends in education businesses over the past several years and discusses pioneering education management ventures, such as the Edison Project and TesseracT Group Inc. Education management organizations (EMOs) have found that the fast-growing charter movement creates a hospitable environment for entrepreneurial efforts. Although private-management efforts have generated intense scrutiny, it is difficult to judge their success or failure. The article describes the mixed results with these schools in Massachusetts, Michigan, and Arizona. Other issues that are examined include contract schools' profitability, efficiency, and the competition they face. Research has shown that many contract schools attempt to make a profit by eliminating extracurricular activities and by streamlining curricula. They also have a tendency to weed out at-risk students to boost test scores, particularly in those states that do not fund special-education students at higher levels than mainstream students. (Contains 34 references.) (RJM)

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Trends and Issues

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Contract Schools

By Margaret Hadderman

Contract (or contracted-out) schools may be viewed as a privatization development that both parallels and builds upon the charter-school movement. As Max Sawicky (1997) points out, the U.S. public sector, including education, has always been privatized, since "cities don't build their own garbage trucks and schools don't write their own textbooks." School districts are increasingly contracting out for support services (like payroll processing and student transportation), for instructional services (like Berlitz International language programs), or, most controversially, for management services to operate programs or entire schools.

Paul Hill and associates (1997) define *contract schools* as "publicly funded schools operated by an independent group of teachers and administrators under a contract with public agency." In their book *Reinventing Public Education*, they argue that every public school should be contracted out to independent providers. The contract would define each school's mission, indicate its level of public funding, and state how it would be held accountable for results.

Under Hill's system, contractors could run the gamut from private-sector entrepreneurs and large business enterprises to teacher unions, higher education institutions, not-for-profit organizations, parent associations, child-advocacy agencies, religious organizations, school administrators, and assorted individuals with good ideas. To minimize risks of incompetency, bidders would have to acquire an "instructional contractor's license."

According to Hill and his colleagues (1997), contract schools have advantages over charter schools, because contract schools' funding is certain, initiation is less marginal, and "contracting creates clear, reliable, and legally enforceable relationships between school operators and public officials." As in charter schools, contracting encourages creation of independent school operators and enables school boards to sponsor schools they do not manage themselves. Contracting is really an "evolutionary development of the charter idea, focusing on the school as the main unit of performance in public education," but allowing more clearly defined public oversight.

Investment in Education Businesses

During the late nineties, about $70 billion was spent yearly on all U.S. for-profit education sectors, "from textbooks and corporate training to child-care centers and postsecondary schools" (Walsh, December 15, 1999). Only recently have these markets and privatization ventures (the product and service sectors) expanded to include actual instruction of K-12 students. This new "schools sector" posted revenues of $28 billion in 1998, according to an April 1999 EduVentures report (Walsh, December 15, 1999).

In November 1999, Edison Schools Inc. (formerly the Edison Project, founded by Chris Whipple) raised $122 million in an initial public stock offering—a milestone for for-profit education, despite Wall Street's lukewarm response (Walsh, December 15, 1999).

By early 2001, the supercharged economy had slowed drastically, and seed money for education-related business was drying up. According to Mark Walsh (August 8, 2001), venture investments in education businesses "declined steadily since a peak of just over $1 billion for the first quarter of 2000"; by the second quarter, "the figure had fallen to $247 million," with nothing going to businesses focused on K-12 instruction. The first quarter of 2001 posted only $134 million in K-12 venture investments, compared with $734 million during 2000. Insufficient venture capital means less first-stage funding for bright ideas and increased merger and acquisition activity (see below).

Pioneering Education Management Ventures: Then and Now

Public Strategies Group, Inc., the first private company to lead an entire school system, succeeded in improving attendance, discipline, achievement, and family involvement under its five-year contract with Minneapolis schools (Bradley 1997, Hutchinson 1997).

Since 1995, National Heritage Academies, based in Grand Rapids, Michigan, has grown from managing one small charter school to operating 22 charters with 7,900 students in Michigan and North Carolina (Schnaiberg 1999).

Advantage Schools, Inc., founded in 1996 by entrepreneur Steve Wilson, favored packaged, generously scripted direct-instruction techniques at charter schools it managed in Worcester, Massachusetts, and 15 other urban districts with fairly high student-aid formulas. Advantage's plan (as of fall 2000) was "to offer a low-cost education to the poor, and, by exploiting the most recent educational reforms, get taxpayers to finance the entire enterprise" while turning a 20 percent profit (Kolbert 2000). Following the announcement of possibly inflated test score gains in spring 2001, Wilson was fired, and Advantage was taken over by Mosaica Education, Inc., a New York-based firm that specializes in managing nonunionized charter schools (Bracey 2001, Golden 2001).

Nobel Learning Communities operates 151 private schools and public charter schools in 16 states. The company bought two Arizona charter schools and a for-profit business college from financially troubled TesseracT in April 2001 (Walsh, August 8, 2001).

In 1995, Beacon Education Management Inc.(then known as Alternative Public Schools) was hired by Wilkinson (Pennsylvania) School District to manage one of its three elementary schools. The company ran into trouble with the teachers' union after replacing the entire faculty with its own staff. In 1998, the contract was terminated when a state court ruled that for-profit management concerns violated state law. In 2001 Beacon operated 29 charter schools serving 10,000 students (Walsh, September 12, 2001) and was "bidding on contracts to run unionized charter schools" (Golden 2001).

Most media attention has focused on the triumphs and troubles of two leading companies—the Edison Project, based in New York City, and Minneapolis-based TesseracT Group Inc. (formerly Educational Alternatives, Inc.). Edison Schools Inc. (as Edison Project), which promotes a respected year-round education program, has had fairly smooth sailing "in its five years of managing public schools for districts and charter groups" (Walsh, May 19, 1999). In 2001, the company operated 136 public schools serving some 75,000 students in 53 cities and 22 states (Gewertz 2001).

Recently, Edison won some prized contracts with Michigan and Pennsylvania districts (after taking over LearnNow). The company has experienced some problems managing its Boston charter school and more serious setbacks in New York, where voters squelched its plans to manage five elementary schools, and in San Francisco, where Edison drew fire for allegedly weeding out minority and disabled students "to inflate performance ratings" (Grimes 2001, Molnar and Reaves 2001). Edison was forced to terminate its contract with the San Francisco Schools and now operates the elementary school in question under a state charter; additionally, Edison must pay rent to the district and will lose $235,000 in funding under a desegregation consent decree (Walsh, July 11, 2001).

Edison recently regained the spotlight for its "$2.7 million contract to review Philadelphia schools" (Johnston 2001). According to the Center for Education Reform website, Edison found that the district "spends too much on maintenance and other nonacademic functions, poorly deploys teachers, and does not track the effectiveness of its many curricular programs." In early November 2001, Pennsylvania's interim governor proposed that Philadelphia schools be taken over by a private management company—to the consternation of city leaders. Under Governor Schweiker's plan, the company would answer to a state-appointed five-member commission that would replace the school board. The EMO would be allowed to replace the district's top fifty-five leaders and have most say over the district's worst performing schools. Although the plan doesn't specify Edison as the chosen manager, the company is anxious to land this contract and direct the nation's largest public-school privatization effort (Gewertz 2001).

Starting in 1991, TesseracT Group Inc., the former Educational Alternatives, Inc., "won contracts with troubled public school districts in Baltimore, Miami, and Hartford," but lost them over disputes involving finances and bureaucratic constraints (Education Week website—Privatization; Stecklow). The company changed direction in the late nineties, opening a few private schools in Arizona, Minnesota, New Jersey, and Indiana. After moving to Scottsdale, an affluent Phoenix suburb, and despite charging high tuition and student transportation fees at its charter and preschools, TesseracT went broke. In October 2000, the company sold off its schools and filed for Chapter 11 bankruptcy protection (Walsh, June 7, 2000).

EMOs: Entrepreneurial Spirit Plus Union Cooperation

According to Stecklow, many education management companies are finding the fast-growing charter-school movement "a more hospitable and entrepreneurial education market." They are already operating 10 percent of all charter schools. In Michigan, the figure is a hefty 70 percent. In some cases, companies are taking over from burnt-out founders struggling to keep schools afloat. When a math and science charter school in Freeland, Michigan, closed after only one year, parents were glad to hire Mosaica Education, Inc. to run a new one in Saginaw. The company brought expertise in curriculum, management, and much-needed financial backing (Schnaiberg 1997).

To gain partners in their entrepreneurial rescue efforts, some for-profits are turning to teacher unions, once deemed "pathological" and obstructive by Advantage Inc.'s Steve Wilson (Golden 2001). The CEO of Edison, with 40 percent of its 113 schools sporting union contracts, has not found unionized teachers particularly inflexible

or anti-reform. The new spirit of togetherness, according to Golden, stems from self-preservation and economic opportunity. EMOs view regular schools as offering "a wider and more lucrative terrain…than charter schools," since startup costs and other capital expenses are avoided or financed by districts. Also, companies can expand faster by acquiring entire districts to manage, instead of having to launch charter schools one school at a time.

In the case of the Inkster, Michigan, system, teachers preferred a partnership with Edison to tackling the uncertainties of a state takeover; in Chester-Upland, Pennsylvania, the union again sided with Edison rather than risking district schools' conversion to nonunionized charters. As previously mentioned, Beacon Education Management is spearheading a drive to acquire unionized public schools. Advantage Inc. had the same idea, until it was taken over by anti-unionist competitor Mosaica Education, Inc.

Evaluating the Performance of Contract Schools

Although "private-management efforts have generated intense scrutiny," it is difficult to judge their success or failure—partly because "few of the jurors approach the task free of preconceived notions" (Walsh, October 20, 1999). Contractors eager to show progress often exaggerate the importance of modest gains, while opponents seize any excuse to end the contract.

Edison Schools Inc. Test Score Gains. A company report issued in spring 1998 touted steadily improving student performance in the twenty-five schools Edison operated (Walsh, March 4, 1998). The American Federation of Teachers found that "academic results were more mixed than the company suggested."

A more recent report, partly prepared by RAND Corporation, states that many Edison schools are continuing to raise test scores as the proportion of students receiving free- or reduced-price lunches rises. Of the 74 Edison-operated schools open during 2000-01, "62 or 84 percent were achieving at higher levels than where they began" (Johnston 2001). Scores on criterion-referenced tests have risen "an average of 6 percentage points every year between 1995 and 2001." However, schools' individual scores and aggregate results were not compared with results for similar schools in their districts. RAND corporation will do a three-year study to disclose those results by 2004.

Managerial and Governance Practices in Massachusetts. A study that examined franchising patterns in four Massachusetts charter schools concluded that "charters managed by EMO's are different from charters managed by other organizations and individuals across the country" (Rhim 1998). The main differences are in governance and size. Charters managed by Sabis and Edison have "relatively prescribed governance structures and academic programs." Although teachers may have considerable autonomy, existence of an outside contractor creates a virtual "central office" atypical of other charter schools. This additional layer (besides the board of trustees) may result in greater regulations.

EMO-run schools, such as Edison's 1,000-student Renaissance Charter School, are larger, perhaps due to private firms' desire "to maximize their space and realize economies of scale" (Rhim). Regular charter schools tend to house about 100 to 200 students.

Recruitment and Cost-Cutting in Michigan. Studies from the University of Michigan suggest that the state's charter schools "were targeting niche markets of parents interested in specific academic programs," shaping "their enrollments by requiring applications and admissions interviews," and providing fewer special-education services than other public schools (Walsh, Arsen and others 1999, Sykes and others 2000). Although researchers did not target for-profit companies, 70 percent of all Michigan charters are run by EMOs.

Another study of eleven privately run charter schools in western Michigan discovered some cost-cutting strategies employed by three companies—the Educational Development Corporation, the Leona Group, and Malone Management (Dykgraaf and Lewis 1998). Despite receiving transportation funds for pupils, only one out of eleven schools provides students with buses. In most schools, parents were persuaded to waive their children's right to special-education entitlements. In ten schools, "special-education students account for only 3 percent of total enrollment, far below the normal 10 to 13 percent in traditional public schools." Students were receiving only minimal services, specifically speech therapy.

Absence of free busing and special programs has consequences for students living in neighborhoods beyond a charter school. Poor students' choice of schools is clearly diminished by lack of transportation. Also, parents may have difficulty getting a list of area charter schools under private management—a further limit on student access.

Problems in Michigan and Arizona. When Thomas Toch (1998), guest scholar at the Brookings Institution, visited three dozen charter schools in Michigan and Arizona, he found "a picture of educational entrepreneurialism" that captured both the benefits and the drawbacks of any market-based enterprise. Although the best charter schools were enthusiastically pursuing innovation and excellence and inspiring surrounding districts to reform their programs, these were exceptions. The vast majority "had problems rarely encountered in traditional public education.

According to Toch, in most Arizona and Michigan charters, "curricula and teaching are weak, buildings are substandard, and financial abuses are surprisingly prevalent." The companies running Arizona's high-school charters (chains such as Excel Education Centers Inc. and the Leona Group) capitalize on Arizona's four-hour attendance requirement for high-schoolers. These companies promise "marginal" students (low-achievers, problem kids, and truants) "a swift and simple route to graduation." Many increase revenues by operating multiple four-hour sessions daily and "substituting self-paced computer instruction for a regular teaching staff."

Academic standards for these and other for-profit high-school charters are low; many teachers are low-paid beginners; and labs, libraries, and even conventional school supplies are scarce. Profiteering (in the form of excess rental charges, enrollment misrepresentations, and sponsor chartering fees) and nepotism are commonplace in both Michigan and Arizona charters. A few converted private schools that shun outsiders may be fostering "social balkanization" and using charter laws to "create public subsidies for private schooling."

Arizona charters are plagued by lack of rigorous oversight, Toch (1998) claimed. Local school systems have not closely monitored the charter schools they sponsor, and chartering boards have been reluctant to tackle abuses. Toch discovered that over three-dozen schools "identified as having education programs bad enough to close were left

alone on the grounds that they weren't physically endangering students or defrauding taxpayers."

Profitability

Judging EMOs' performance is difficult, since "many young companies are privately held and not required to report their financial data to the public" (Walsh, November 24, 1999). Sylvan and Nobel Learning Communities are profitable. TesseracT is now out of the picture, since filing for Chapter 11 bankruptcy in October 2001. Edison may fail as an EMO (it lost $38 million on fiscal 2001 revenues of $376 million), but might still profit from marketing products such as new curricula, professional development programs, and educational software (Levine 2000).

Beacon Education Management Inc. is said to be close to profitability, despite losing $2.7 million on revenues of $16 million in 2000 (Walsh, September 12, 2001). Beacon was hoping to raise $33 million in its initial public offering in July 2001, "but the IPO was pulled at virtually the last minute, with Beacon and its underwriters citing poor market conditions"(Walsh, September 12, 2001). Neither Mosaica nor Advantage has made its losses public (Walsh, September 12, 2001). Despite promises of increased revenue from charters (and Internet courses), most EMOs to date are operating in the red.

Business analysts such as Merrill Lynch say the education field today resembles the health field of yesterday: "a highly fragmented cottage industry, inefficient, with limited professional management" and little use of technology (Walsh, November 24, 1999).

Economist Harry Levin, director of the Center for the Study of Privatization in Education at Teachers College in New York, says business acumen is not sufficient to salvage a failing school and turn a profit (Kronholz, February 12, 1999). Because most states require lotteries to fill seats and most charters are in inner cities, "charters face the same problems that traditional public schools find so insolvable." Many educators believe "profits can be obtained only by depriving children of services and opportunities that would help them to succeed in school" (Plank and Sykes 2000).

Competition and Efficiency

Evidence from Massachusetts (and other states) suggests that "while charter schools have 'competitors' for students, EMOs are not competing for contracts in the economic sense" (Rhim 1998), but are able to sew up contracts during the application process. Rhim believes policymakers should act to "infuse an appropriate amount" of competitive bidding into the contracting process.

EMOs' claims of greater efficiency should also be examined. According to three Michigan State University researchers, for-profit firms earn their money in three ways: by reducing labor costs (via cuts in employment and compensation); by using economies of scale (operating larger facilities and providing standardized curricula, financial, and administrative services); and by providing fewer student services (like transportation, school lunches, intramural athletics, band and orchestra, and extracurricular activities) (Plank and Sykes 2000).

Sharp business practices are favored by some private companies to ensure profits (Johnson 2001). These practices include contracting consulting services for predetermined fees; arranging that all cost savings from contracted services flow to contractors; appending a fee apart from inclusion of the district's labor and materials in the contract; including a profit or markup on equipment and supplies purchased on the district's behalf; inflating first-year costs with one-time expenses; and using proceeds from sale of corporate stock or securities.

To avoid misunderstandings and fiscal mismanagement, Jon Schroeder (August 1999), of the Charter Friends National Network, recommends that districts consider key issues before contacting for school-management services. School-district officials or charter-school boards should ascertain which services are being purchased, who has key decision-making authority, the terms of the contract, how the contract will be monitored, how the management company will be compensated, how the budget will be set and revised, who owns the school's physical and intellectual property, and how this property will be divided if the contract is terminated.

The National School Boards Association has issued guidelines (Johnson 2001) to help school districts determine whether a private firm could provide the service or goods more efficiently or less expensively than the district; whether contacting will affect other district services; whether a sufficient supply of firms exists to ensure competitive bidding; and whether unsatisfactory contractors can be replaced.

EMOs' rhetoric doesn't always match reality, according to a University of New Mexico study that examined website design, imagery, and a language of six major for-profit companies: Advantage, Bacon, Edison, Leona Group, Mosaica, and National Heritage Academies (Pini 2001). An EMO might "promise competitiveness, efficiency, and consumer choice, but may also ignore the concerns of equity, citizenship, and solidarity." Corporate marketing strategies using misleading advertising, oversimplified evidence, and evocative rhetoric may obscure or distort differences between corporate goals and public-education benefits. EMOs' claims for having smaller classes, longer school days, and greater technology use may be accurate; however, EMOs' need for constant corporate expansion to remain profitable; tendency to hire young, experienced, and nonunionized teachers; and reliance on parental volunteer work do not appear in promotional literature (Pini 2001).

The most powerful component of the service-reduction strategy is "to specialize in the education of less costly students." Elementary students are less expensive to educate than secondary students, and teaching regular K-12 students costs less than teaching limited-English or disabled students. States (such as Michigan) that provide the same subsidy for every student in a local district provide a strong incentive to educate mostly "mainstream" elementary students (Plank and Sykes 2000).

Some companies that do target minority and disadvantaged students weed out hard-to-teach youngsters or use scripted, unimaginative teaching and disciplinary techniques. Concentrating large numbers of poor black and Hispanic kids in these "alternative" settings (because their needs are supposedly different from those of kids from affluent suburban families) may expand urban parents' limited schooling choices, but have a ghettoizing effect in the long run, states Kolbert (2000).

One motivation for a district in choosing to contract out some of its services might be to improve its schools through competition and the diffusion of innovation. This may

happen even without being hired, as Edison discovered in spring 1999. The company's mere proposal to launch a 600-student charter school in Toledo, Ohio, inspired the district and local AFT union to create their own innovative school. The K-4 Grove Patterson Academy enrolls 220 students, has a waiting list of 400, and offers Success for All, Spanish and German language instruction, and home computers for students. All are hallmark Edison program features.

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